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No. 90-1709

Supreme Court, U.S.
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In the Supreme Court of the United States

OCTOBER TERM, 1990

JEHAN-DAS, INC., PETITIONER

v.

UNITED STATES OF AMERICA, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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QUESTION PRESENTED

Whether the bankruptcy court properly denied petitioner's request to allocate a liquidating distribution under Chapter 11 of the Bankruptcy Code to the "trust fund" portion of petitioner's federal tax liabilities.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A2 to A7) is reported at 925 F.2d 237. The opinion of the district court (Pet. App. B4 to B21) is unreported. The opinion of the bankruptcy court (Pet. App. C4 to C26) is reported at 91 Bankr. 542.

JURISDICTION

The judgment of the court of appeals was entered on February 1, 1991. The petition for a writ of certiorari was filed on May 1, 1991. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Petitioner filed for reorganization under Chapter 11 of the Bankruptcy Code (11 U.S.C.) on October 20, 1981.

Petitioner continued to operate its business as debtor in possession until 1984, when it ceased operations. A plan of reorganization was not filed, and petitioner was eventually liquidated within the Chapter 11 proceedings.

While operating as debtor in possession, petitioner failed to pay both "trust fund" taxes and "non-trust fund" taxes to the government (Pet. App. C5). "Trust fund" taxes are those income and social security taxes that an employer is required to withhold from the wages of employees and pay over to the government. If the persons responsible to collect, account for, and pay over trust fund taxes willfully fail to do so, they are personally liable for a penalty in the amount of the unpaid "trust fund" taxes. See 26 U.S.C. 6672. The Internal Revenue Service determined that petitioner's president, John Royal, was a "responsible officer" who willfully failed to pay over the trust fund taxes to the government. The Service therefore assessed a penalty against Royal in an amount equal to those taxes pursuant to 26 U.S.C. 6672 (Pet. App. C6).

At the time of liquidation, petitioner owed approximately $148,000 for "trust fund" and "non-trust fund" taxes (Pet. App. C5). Petitioner did not dispute that the government's claim for these taxes was entitled to priority and that the funds in the estate (approximately $59,000) were insufficient to pay the claim in full. Petitioner did, however, request the bankruptcy court to direct the IRS to apply the liquidation distribution first to the "trust fund" portion of the taxes owed. As petitioner acknowledges (Pet. 6), the sole purpose for such an application would be to decrease Royal's personal liability under Section 6672. The IRS collects the full amount of the "trust fund" liability only once, whether payment is first received from the corporation or from the responsible person. See *USLIFE Title Insurance Co.* v. *Harbison*, 784 F.2d 1238, 1243 (5th Cir. 1986). The IRS, however, applies payments first to a debtor's "non-trust

fund" liability, thereby preserving its right to pursue the responsible person in the event of a shortfall to enhance the prospect of eventually being made whole. See *United States* v. *Energy Resources Co.*, 110 S. Ct. 2139, 2143 (1990). The IRS honors a taxpayer's designation of payments among various taxes due *only* where the payment is voluntary. See Rev. Rul. 73-305, 1973-2 Cum. Bull. 43, modified by Rev. Rul. 79-284, 1979-2 Cum. Bull. 83.

On October 17, 1988, the bankruptcy court issued its memorandum opinion holding that the liquidating distribution was not "voluntary" and that petitioner therefore could not designate how the distribution should be applied by the IRS. The court determined whether the payment was voluntary by reviewing all of the circumstances (Pet. App. C20-C25). The court noted that petitioner had been liquidated and that no agreement had been reached between petitioner and the IRS concerning payment of either the "trust fund" or "non-trust fund" taxes (*id.* at C22). The court also noted that petitioner, as debtor in possession, was "not free to deal with this property as he chooses, but holds it in trust for the benefit of creditors" (*id.* at C23). In seeking to designate the payment of taxes to be applied first against the "trust fund" liability, petitioner was not acting for the benefit of its creditors but was acting only for the benefit of Royal, its president (*id.* at C24). Under these circumstances, the court found the payment to be involuntary (*id.* at C25). The district court affirmed (Pet. App. B2-B3).

2. The court of appeals also affirmed. The court stated that "[t]here is no bright line identifying payments to the IRS as voluntary or involuntary." Pet. App. A5. After examining the specific facts of this case—including that petitioner had liquidated its assets under the control and supervision of the bankruptcy court; that it could not distribute those funds without court approval; that the court had

already ordered petitioner to pay the IRS; and that the bankruptcy case could not be closed until petitioner made the payment (*id.* at A6)—the court concluded that petitioner had no choice but to pay the funds to the IRS and that the payment was therefore not voluntary (*ibid.*).

ARGUMENT

The court of appeals correctly held that the liquidating distribution from petitioner's estate was not a voluntary payment of taxes. The decision of the court of appeals does not conflict with any decision this Court or of the other courts of appeals. Further review is therefore not warranted.

1. It is the long-standing policy of the Internal Revenue Service that, when a payment is voluntarily made, the IRS will accede to the taxpayer's request that the payment be applied to a specific portion of the taxpayer's tax liability. See, *e.g.*, *IRS* v. *Energy Resources Co.*, 871 F.2d 223, 227 (1st Cir. 1989), aff'd, 110 S. Ct. 2139 (1990). In this case, the court of appeals held, after examining the relevant factors, that the distribution was not a voluntary payment. The court noted that petitioner had liquidated its assets under the control and supervision of the bankruptcy court, that the bankruptcy court had ordered that the federal taxes be paid, and that the case could not be closed until the funds were distributed. The bankruptcy court also noted that any designation of the funds would be for the sole benefit of petitioner's president, who would have his personal tax liability reduced, and not for the benefit of petitioner's creditors, in whose best interest petitioner (as debtor in possession) was required to act. Under these circumstances, the court correctly held that the liquidating distribution was not voluntary and that petitioner therefore could not direct the IRS how to apply the payment.

2. This decision does not conflict with the decision of any other court of appeals. Indeed, the courts uniformly

have held that a debtor has no right to direct the application of tax payments in a Chapter 11 proceeding because such payments are involuntary. *IRS* v. *Energy Resources Co.*, 871 F.2d 223, 230 (1st Cir. 1989); *DuCharmes & Co.* v. *Michigan*, 852 F.2d 194, 196 (6th Cir. 1988); *United States* v. *Technical Knockout Graphics, Inc.*, 833 F.2d 797, 802 (9th Cir. 1987); *In re Ribs-R-Us, Inc.*, 828 F.2d 199, 202-203 (3d Cir. 1987).[1] Thus, contrary to petitioner's contentions (Pet. 7-16), there is no conflict among the circuits on the issue addressed and resolved in this case.

Petitioner further contends (Pet. 11-16), however, that the courts of appeals are divided in their method of analysis of the question whether a tax payment by a Chapter 11 debtor is voluntary. According to petitioner (Pet. 11-14), the First and Eleventh Circuits use a "case by case" approach, the Third, Sixth and Ninth Circuits have adopted a rule that such payments are involuntary per se, and the court of appeals here found an unspecified middle ground. Petitioner apparently favors the formulation of a "bright line" (Pet. 18), although it takes issue with the placement of that line by the courts of appeals that have drawn one.

The short answer to petitioner's conflict-in-approach argument is that each of the decisions that has addressed the question has held that payments by a debtor in Chapter

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[1] The only contrary appellate decision (*United States* v. *A & B Heating & Air Conditioning, Inc.*, 823 F.2d 462, 465 (11th Cir. 1987)) was vacated by this Court and remanded for consideration of mootness. 486 U.S. 1002 (1988). The debtor in that case moved to delete the provision in its Chapter 11 plan designating how the taxes were to be applied, and the court of appeals ordered the case to be dismissed as moot. 878 F.2d 1311 (11th Cir. 1989). The case therefore lacks any precedential value. See *County of Los Angeles* v. *Davis*, 440 U.S. 625, 634 n.6 (1979).

11 are involuntary.[2] Even if the circuits have employed differing modes of analyses with respect to the question presented by this case, petitioner would not prevail under any of them.

3. Petitioner errs in contending (Pet. 20) that the decision of the court of appeals conflicts with this Court's holding in *United States* v. *Energy Resources Co.*, 110 S. Ct. at 2142, that bankruptcy courts have broad authority to modify debtor-creditor relationships in approving Chapter 11 plans. In *Energy Resources*, the Court held that bankruptcy courts in a Chapter 11 case may direct the manner in which tax payments are applied by the IRS when such an allocation is "necessary for the success of a reorganization plan." 110 S. Ct. at 2140. See *id.* at 2142, 2143. The present case, however, does not involve a question of the bankruptcy court's authority nor a question of the imperatives of a plan of reorganization. This proceeding arises from a liquidation of the debtor's assets, not a reorganization. Moreover, the bankruptcy court denied petitioner's proposed allocation specifically because it represented an abuse of the fiduciary obligations petitioner owed to its creditors. The decision of the court of appeals is thus entirely consistent with this Court's decision in *Energy Resources*.

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[2] Petitioner also suggests (Pet. 15-16) that the decision in this case conflicts with the Seventh Circuit's decision in *Muntwyler* v. *United States*, 703 F.2d 1030 (1983). But as petitioner acknowledges elsewhere (Pet. 10), the *Muntwyler* court specifically refused to equate the nonjudicial assignment for the benefit of creditors before it in that case with a proceeding under the Bankruptcy Code. The court specifically distinguished the two situations, noting that "[t]he Government might have been correct in its claim [that the tax payment was involuntary] if the corporation had been in bankruptcy, which it was not." 703 F.2d at 1034 n.2.

CONCLUSION

The petition for a writ of certiorari should be denied.
Respectfully submitted.

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